No. 15942

In the United States Court of Appeals for the Ninth Circuit

RICHARD DOUGLAS FURNISH AND EMILIE FURNISH FUNK, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petitions for Review of the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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INDEX

	Page
Opinion below	1
Jurisdiction	1
Questions presented	1
Statute involved	3
Statement	4
Summary of argument	17
Argument:	
I. The Tax Court correctly upheld the Commissioner's determination of deficiencies for each of the taxable years 1939 through 1949	20
A. Taxpayer concedes that he grossly understated his taxable income for eleven successive years	21
B. The Commissioner's determination clearly reflects taxpayer's income	22
1. The item of income in controversy is taxpayer's gross professional income	22
2. The Commissioner's determination of the taxpayer's gross professional income is based upon the taxpayer's own audit	23
3. The audit amply supports the determination, even if it were not supplied by the taxpayer	24
4. Taxpayer's attack upon the determination of his true income is without substance	26
(a) The net worth statement does not clearly reflect income	26
(b) There are no errors in the audit	28
(c) The other objections are unsupported by any evidence	29
II. The Tax Court correctly found that taxpayer filed a false and fraudulent return with intent to evade taxes for each of the years 1939 through 1948 so that the assessment and collection of deficiencies is not barred by the statute of limitations and taxpayer is subject to the additional tax provided by Section 293(b)	30

Argument—Continued | Page

III. The Tax Court correctly held that the returns filed for 1939 through 1942 were joint returns of the husband and wife, making each liable for any deficiencies with respect thereto under Section 51(b) of the 1939 Code 33

A. The legislative history of Section 51(b) shows that Congress clearly intended to impose joint and several liability on the husband and wife as a condition to the privilege of securing the benefit of lower tax rates by a joint return 34

B. The decided cases have squarely carried out the plain terms of the statute and held a spouse liable for all deficiencies, including those for fraud, regardless of participation in the fraud 37

Conclusion 40

CITATIONS

Cases:

Amen v. *Black*, 234 F. 2d 12, remanded, 355 U. S. 600 39
Anderson v. *Commissioner*, 250 F. 2d 242 .... 24, 27, 30
Bechelli v. *Hofferbert*, 111 F. Supp. 631 26
Bender v. *Commissioner*, decided July 1, 1958 30
Boyett v. *Commissioner*, 204 F. 2d 205 37
Brown v. *Oxtoby*, 45 Cal. App. 2d 702 39
Burka v. *Commissioner*, 179 F. 2d 483 24
Cole v. *Commissioner*, 81 F. 2d 485 .... 35, 36, 39
Commissioner v. *Rabenold*, 108 F. 2d 639 35
Commissioner v. *Uniacke*, 132 F. 2d 781 38
Crowe v. *Commissioner*, 86 F. 2d 796 35
Friedberg v. *United States*, 348 U. S. 142 27
Funk v. *Commissioner*, 29 T. C. 279 1
Harber v. *Commissioner*, 249 F. 2d 143, certiorari denied, 355 U. S. 95 .... 30, 31
Harris v. *Commissioner*, 174 F. 2d 70 31
Helvering v. *Mitchell*, 303 U. S. 391 .... 33, 38
Holland v. *United States*, 348 U. S. 121 .... 26, 27, 30
Howell v. *Commissioner*, 175 F. 2d 240 37

Cases—Continued | Page

Kann v. *Commissioner*, 210 F. 2d 247, certiorari denied, 347 U. S. 967 37
Lipsitz v. *Commissioner*, 21 T. C. 917, affirmed, 220 F. 2d 871 32
Macias v. *Commissioner*, decided May 7, 1958 38
Meier v. *Commissioner*, 199 F. 2d 392 29
Miller v. *Commissioner*, 237 F. 2d 830 27
Moore v. *United States*, 37 F. Supp. 136, certiorari denied, 355 U. S. 955 .... 30, 31
314 U. S. 706 35
Phillips v. *United States*, 59 F. 2d 881, certiorari denied, 287 U. S. 639 39
Pool v. *Commissioner*, 251 F. 2d 233, certiorari denied 356 U. S. 938, rehearing denied 356 U. S. 978 20
Remmer v. *United States*, 205 F. 2d 277, reversed, 347 U. S. 450 .... 26, 30
Rogers v. *Commissioner*, 111 F. 2d 987 31
Sachs v. *Commissioner*, 111 F. 2d 648 35
Schwarzkopf v. *United States*, 246 F. 2d 731 30
Seifert v. *Commissioner*, 157 F. 2d 719 31
Smith v. *United States*, 348 U. S. 147 27
Sullivan v. *Commissioner*, decided May 26, 1958 37
Williamson v. *Clapper*, 88 Cal. App. 2d 645 39
Wiseley v. *Commissioner*, 185 F. 2d 263 31

Statutes:

Internal Revenue Code of 1939:
Sec. 41 (26 U. S. C. 1952 ed., Sec. 41) 3
Sec. 51 (26 U. S. C. 1952 ed., Sec. 51) 3
Sec. 145 (26 U. S. C. 1952 ed., Sec. 145) 16
Sec. 293 (26 U. S. C. 1952 ed., Sec. 293) 4
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 51 34
Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 51 35

Miscellaneous:

IV Wigmore on Evidence (3d ed.), Sec. 1078 24
House Hearings, Revision of Revenue Laws, 1938, pp. 57-58, 85 35

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and conclusions of law of the Tax Court (R. 76-110) are reported at 29 T.C. 279.

JURISDICTION

The petitions for review involve federal income taxes for the taxable years 1939 through 1949. On September 11, 1953, the Commissioner mailed to both taxpayers a notice of deficiency for 1939 through 1942, joint tax years. (R. 20-27.) On September 11, 1953, the Commissioner mailed to the taxpayer Richard Douglas Furnish a notice of deficiency for

1943 through 1949, his separate tax years. (R. 37-51.) Within ninety days thereafter and on December 4, 1953, taxpayer Emilie Furnish Funk filed a petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954 for the years 1939-1942. (R. 3-14.) On December 7, 1953, (R. 27, 51), taxpayer Richard Douglas Furnish filed similar petitions, one for the joint years, 1939-1942, (R. 15-20), the other for the separate years, 1943-1949 (R. 28-36). The three petitions were consolidated and tried together. (R. 128.) The decisions of the Tax Court were entered on November 21, 1957. (R. 111-113.) The case is brought to this Court by petitions for review filed by each taxpayer February 17, 1958. (R. 114-118.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court erred in holding that the amount of the deficiency for each of the taxable years 1939 through 1949 was correctly determined by the Commissioner.

2. Whether the Tax Court correctly found that the taxpayer had filed a false and fraudulent return with intent to evade taxes for each of the years 1939 through 1948 so that taxpayer was subject to the tax provided by Section 293(b) of the 1939 Code.

3. Whether the assessment and collection of deficiencies for any of the taxable years is barred by the statute of limitations.

4. Whether the returns filed for the years 1939 through 1942 were joint returns of the taxpayers husband and wife, or the separate return of the husband.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 51. INDIVIDUAL RETURNS.

* * * *

(b) *Husband and Wife.*—In the case of a husband and wife living together the income of each (even though one has no gross income) may be included in a single return made by them jointly, in which case the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several. No joint

return may be made if either the husband or wife is a nonresident alien.

*   *   *   *

(26 U.S.C. 1952 ed., Sec. 51.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

*   *   *   *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

STATEMENT

The facts as found by the Tax Court (R. 76-98) can be summarized as follows:

Taxpayer Richard Douglas Furnish (hereafter referred to as taxpayer) resides in Hollywood, California. During the years involved he was a doctor of medicine and practiced in Los Angeles, California. Taxpayer Emilie Furnish Funk (hereafter referred to as Mrs. Funk) resides in Arcadia, California; she is the former wife of Furnish. (R. 79.)

Taxpayers were married in 1923 at Omaha, Nebraska, while Furnish was a medical student. Four children were born of the marriage. He interned in Florida in 1925 and practiced medicine there until 1931, filed no returns for 1925, 1926, 1927, 1930, or 1931, and he filed returns for 1928 and 1929 showing

no tax due. In 1931 one of his automobiles was repossessed. He and his family then moved to Scobey, Montana, where he practiced for approximately two years. (R. 79-80.)

In 1933, taxpayers moved to Los Angeles. During the following two years, taxpayer traveled extensively around the country, engaging in the business of promoting and selling a serum for the injection treatment of hernia, imported from Spain, and two other products, one from Canada and one from Japan. He was away from his family except at Christmas. During this period his wife supported herself and the children in Los Angeles selling medicine which she bought out of a small inheritance from her father. She lived in inexpensive quarters that were furnished with secondhand furniture. She was unable to keep up the payments on this furniture, which was repossessed. Taxpayer then joined his family in Los Angeles and they moved to a furnished 2-bedroom apartment which was rented for $35 a month. They lived in that apartment for several years, until taxpayer purchased a house at 121 Highland Avenue. He had to borrow $1,000 in order to make the down payment. Title was taken in the name of his cousin. (R. 80.)

Taxpayer began to practice medicine in Los Angeles in 1936. Since he was not a member of the Los Angeles County Medical Association, he had difficulty in obtaining hospital facilities for his patients. In 1942 and 1943 he finally acquired interests in two hospitals. He devoted long hours to the practice of medicine in Los Angeles. (R. 81.)

Mrs. Furnish was granted an interlocutory decree of divorce from taxpayer in 1944. For the years 1943-1949, inclusive, he filed individual income tax returns. For each of the years 1939-1942, inclusive, a return was filed that was signed by both the taxpayers. The returns for 1939 and 1940 had been destroyed and were not available at the time of trial. The 1941 and 1942 returns were presented in evidence. The signatures of both taxpayers appear at the bottom right hand corner of the first page of these two returns immediately over the following printed instruction: "If this is a joint return (not made by agent), it must be signed by both husband and wife." However, in the caption at the top of the first page of these returns there appears only the name "Richard Douglas Furnish" over the printed instructions to the following effect: "(Use given names of both husband and wife, if this is a joint return)." Mrs. Furnish is not listed as a dependent on these returns and exemptions were claimed in the 1941 and 1942 returns in the amounts of $1,500 and $1,200, respectively, the maximum amounts that were allowable to both husband and wife for those years. She filed no separate returns for the years 1939-1942, inclusive, and had no separate income during such years. (R. 81-82.)

The return for each of the years 1939-1942 was signed in blank by Mrs. Furnish at her husband's request, and he thereafter filled it out. She did not know of the contents of the return, nor was she aware of the fact that her husband had received unreported income. They were living together as husband and wife during this period. In connection with the

divorce proceedings taxpayers entered into a property settlement agreement on October 27, 1944, in which the husband agreed to pay the wife $10,000 at once plus an additional $40,000 at the rate of $400 a month. He also transferred to her his interest in a Pontiac automobile and certain household objects. He concealed from her the full extent of his assets. (R. 82.)

Taxpayer was secretive in his financial transactions, and followed the practice of taking title to property in the names of nominees. Among the reasons for such secretivenes was the state of his relationship to his wife and his fear of lawsuits. (R. 82.)

During the taxable years, taxpayer purchased five pieces of real property in Los Angeles; in each case, title to the property was taken in the name of another, his business agent Duelke, his aunt R. M. Scanlon, one Ramseyer, his former nurse, Elodia Sullivan and a cousin, C. T. Scanlon. Taxpayer furnished the funds, in cash, in one case, $25,000 in bills of small denominations. Two of the properties (401 North Vermont and Florence Avenue and Crenshaw Boulevard) were sold through others and arrangements made for taxpayer to receive the proceeds in cash from the nominal sellers. Taxpayer said that he did not want the checks traced to him because he was allegedly involved in some lawsuits. (R. 82-88.) The gains from the sale of the properties were reported by the nominal title holders. (R. 88.)

By the use of nominees to report the gains derived from the sales of the 401 North Vermont and the Florence and Crenshaw properties, petitioner evaded substantial amounts of income tax. ·The amount of

taxes paid by such nominees with respect to those gains was substantially less than the amount of taxes that petitioner would have had to pay, had he included those gains in his returns. (R. 88.)

Taxpayer also caused nominees to purchase shares of stock (Thomas Steel Company and Parkview Hospital (R. 84-85, 88)) for him, and he failed to report the dividends as income. (R. 88; see also R. 100, 240.)

Taxpayer followed the practice of sending patients' checks to his sister in Kansas City where she cashed the checks and accumulated the currency for him. Sometime prior to 1946 the accumulated currency, amounting to approximately $25,000, was transmitted to him by express. He continued the practice of sending patients' checks to his sister to be converted into currency, and in the latter part of 1947 his sister personally transmitted an additional $25,000 in accumulated currency to him. (R. 88-89).

Taxpayer consistently followed the practice of carrying his bank accounts in the names of employees or relatives. The accounts carried in the name of Herman Duelke bore a designation after his name of either "business manager" or "trustee," without, however, identifying taxpayer as the owner of the accounts; taxpayer's business address was used as the address of Duelke. Taxpayer also maintained some small accounts in the names of relatives. (R. 89.)

At the start of the investigation of his returns by agents of the Internal Revenue Service in January 1949, taxpayer stated to a special agent of the Intelligence Division of the Internal Revenue Service that he had never bought or sold any real estate in California at any time, nor had he asked anyone else for

the use of his name in the purchase or sale of a parcel of real estate. In fact, taxpayer had engaged in numerous real estate transactions buying and selling property through nominees, and at the time of the interview owned three pieces of property held in the names of nominees. His 1946 tax return showed a sale of real property known as the Bonnie Brae Medical Building. (R. 89.)

During the same interview, when confronted with his 1946 income tax return showing income from rents from the Hinton Arms apartment house, taxpayer stated to the special agent that he did not own that building, that it was the property of his business manager, Duelke, and that he had leased it from Duelke. In fact, taxpayer was the real owner of the Hinton Arms and Duelke was merely his nominee. (R. 89-90.)

Duelke tried to install an accurate record system for taxpayer, who would not allow him to do so and inquired as to how, "with 130,000,000 people," he could be checked by the Bureau of Internal Revenue. During the year 1946 taxpayer told Duelke that he had been previously investigated by the Bureau of Internal Revenue at his office, and had removed some of his records from his office to his home. (R. 90.)

No set of books adequately reflecting income was maintained by taxpayer. In the initial stages of the investigation leading up to the present proceedings, the revenue agents attempted to determine his correct income from payments disclosed by patient history cards maintained in his office. It became apparent to the agents that not all the cards were

made available to them. When questioned concerning this, taxpayer stated to the agents that certain files were lost in moving his office. Subsequently he hired an attorney. In August 1949, at the office of the Intelligence Division, this attorney stated that it was to the interest of his client to cooperate with the Government, that there would be no longer a claim of lost files, and that they were going to have an audit made of his patient record cards to determine the amount of income he had received and would present this audit to the Government. All of the patient record cards were then made available to the investigating agents. (R. 90-91.)

Taxpayer's attorney employed a certified public accountant, Harry K. Hill, to make an audit for the purpose of determining as nearly as possible the amount of gross income received by taxpayer from his patients over the years 1939-1948, inclusive, as disclosed by the patient record cards maintained in his office. A typical patient record card contained the name of the patient, the medical history and treatment afforded the patient, and the amounts and dates of payments made by the patient. These cards were used by taxpayer's office staff as the basis of preparing bills sent out to the patients. (R. 91.)

In making his audit Hill examined all the patient record cards. Whenever he could not reasonably determine from his examination of any cards the amount paid or year of payment those cards were segregated. The segregated cards were then worked over separately with Irma Wheeler or Ruby Saunders, office employees of taxpayer. Any cards which could not

be explained by them were submitted to the taxpayer for clarification. Irma Wheeler had been employed by taxpayer since 1942 for general office work, with duties which included making entries on the patient record cards and billing patients. Ruby Saunders was employed from the latter part of 1948 until 1952 with similar duties. She installed a new system of making entries on the cards, but she had to be familiar with the old system in order to bill patients for charges incurred prior thereto. (R. 91.)

Upon the completion of the Hill audit in June 1950, it was turned over to the Internal Revenue Service by taxpayer's attorney. A special agent checked Hill's work papers with the transcript he had made from approximately 3,000 patient record cards which had been made available to him in the initial stages of the investigation. The special agent also took the work papers to taxpayer's office to make test checks against patient record cards which had not previously been made available to the Government. The special agent consulted with Irma Wheeler, Ruby Saunders, or taxpayer whenever there was an ambiguity in a particular card. Of approximately 3,900 cards checked by the special agent against the Hill audit only a few discrepancies were noted, and these were of a comparatively minor character and generally were in favor of taxpayer. (R. 92.)

In making test checks of the Hill audit against the cards previously withheld, the special agent in general made samplings based upon an arbitrary selection of certain letters of the alphabet. Thus, in transfer file No. 1 he checked 75 cards in the letters A and B,

of which there were 700, and did not check the rest of the alphabet; in transfer file No. 2 he checked 200 cards in the letter P, of which there were 1,200, and did not check the rest of the alphabet; in transfer file No. 2A he checked 150 cards in the letter E, of which there were 1,300, and did not check the rest of the alphabet; in transfer file No. 3 he checked 200 cards in the letters A and C, of which there were 600, and did not check the rest of the alphabet; in transfer file No. 4 he checked 150 cards at random, of which there were between 1,200 and 1,300; in transfer file No. 4A he checked 50 cards at random, of which there were between 900 and 1,000; in transfer file No. 5 he checked 75 cards at random, of which there were 500. (R. 92-93.)

The gross receipts derived by taxpayer from his medical practice for the years 1939-1948, as reported in his income tax returns, and the gross receipts disclosed by the patient record cards according to the Hill audit were as follows:

Year	*Gross Receipts Reported*	*Gross Receipts per Hill Audit*
1939	Return Unavailable	$17,720.88
1940	Return Unavailable	27,734.16
1941	$20,826.00	48,685.06
1942	25,642.00	66,252.56
1943	21,374.46	106,558.90
1944	26,521.50	107,230.58
1945	41,188.31	93,621.83
1946	55,493.08	141,542.82
1947	32,821.11	110,695.16
1948	57,330.03	81,892.84

The actual gross receipts from patients were not less than those shown by the Hill audit. (R. 93.)

In determining the deficiencies for the years 1941-1948, inclusive, the Commissioner included in gross income the gross receipts from patients as shown in the Hill audit, and unreported dividends, interest, and gains from the sale of properties. From these receipts he deducted claimed expenses and such unclaimed expenses as were found in the course of the examination of the income tax returns, and thus arrived at net income. For the years 1939 and 1940, since claimed expenses could not be ascertained because returns and expense records were not available, net income was determined by applying to gross receipts for these 2 years shown in the Hill report the average percentage of net income from profession to gross receipts from profession based on the 2 succeeding years, 1941 and 1942. (R. 93-94.)

In determining the deficiency for the year 1949, the Commissioner added to the net income reported by taxpayer $2,936.85 for unreported dividends, $863.15 for unreported interest, $5,655.59 for understatement of net profit from profession, and $100 for a disallowed tax deduction. He allowed additional deductions of $67.58 for interest paid and $120 because of a mathematical error in the return. (R. 94.)

The amounts of net income as reported for the years 1939-1949 and as determined by the Commissioner are as follows (R. 94-95):

Year	*Net Income Reported*	*Net Income Determined by the Commissioner*
1939	$ 4,555.56	$ 12,681.05
1940	5,615.83	20,093.99
1941	7,632.84	35,137.76
1942	8,477.53	48,753.90
1943	6,884.68	49,174.25
1944	12,134.10	94,601.66
1945	19,950.18	80,225.42
1946	18,212.16	126,627.00
1947	115.81	84,342.75
1948	17,828.99	97,874.95
1949	35,950.50	45,318.51

The Commissioner thus did not use the net worth method to determine taxpayer's true income, but instead determined taxpayer's income from specific taxable sources, professional receipts, dividends, interest and gains from sale of properties. (R. 93-94.)

A net worth statement purportedly reflecting assets, liabilities, and nondeductible expenses of taxpayer for the years 1939-1948 was prepared by another accountant employed by him. That net worth statement was presented in evidence on behalf of taxpayer as correctly disclosing net income for those years as follows (R. 95):

1939	$30,773.28
1940	58,541.04
1941	55,529.22
1942	56,770.86
1943	55,685.22
1944	19,728.82
1945	53,847.59
1946	50,666.92
1947	74,389.45
1948	73,922.44

The accountant who prepared the net worth statement made an extensive search to determine all of the investments made by taxpayer, and received some help from him. All items of property discovered by him or the Government agents are included in the net worth statement. However, the amount of cash on hand shown on the net worth statement is based, at lease as of January 1, 1939, and as of the end of the years 1939, 1940, and 1941, upon statements made to him by taxpayer. (R. 96-97.) The net worth statement showed cash on hand as follows (R. 97):

January 1, 1939	$ 46,000
December 31, 1939	71,000
December 31, 1940	111,000
December 31, 1941	142,943
December 31, 1942	175,443
December 31, 1943	184,143
December 31, 1944	106,943
December 31, 1945	125,163
December 31, 1946	96,563
December 31, 1947	2,063
December 31, 1948	36,649

The Commissioner's method of determining net income is more accurate than the net worth method in the circumstances of this case; the Commissioner's determinations of net income for the years involved are correct. (R. 97.)

In his return for each of the years 1944, 1945, and 1948, taxpayer omitted gross income received by him during such year that was in excess of 25 per cent of the gross income stated in the return. After a plea of *nolo contendere*, taxpayer was convicted by the District Court, Southern District of California, Central Division, on two counts for violations of Section

145(b), Internal Revenue Code of 1939, such counts representing the years 1947 and 1948. (R. 98.)

The Tax Court concluded with the finding that the returns of the taxpayers for the years 1939-1942, inclusive, and the returns of taxpayer Furnish for the years 1943-1948, inclusive, were false and fraudulent with intent to evade tax, and a part of the deficiency determined for each of the years 1939-1948, inclusive, is due to fraud with intent to evade tax. Such fraud was that of taxpayer Furnish alone. (R. 98.)

As to the question of whether the returns for 1939 through 1942 were joint or only the separate return of taxpayer, the Tax Court, in its opinion, found that the returns were signed by Mrs. Funk, were intended to be and were in fact joint returns. (R. 106-107.) The income shown on the returns from taxpayer's medical practice was community property under California law, and this income had to be reported either in its entirety in a joint return, or Mrs. Funk could report her half in a separate return. She did not file any separate returns for the years 1939-1942. (R. 107.) Her contention that she signed under duress was rejected by the Tax Court as based on insufficient evidence. (R. 108-109.) Accordingly the Tax Court held that the returns filed for the years 1939-1942, inclusive, were joint returns of taxpayers, and that each of them is jointly and severally liable for the deficiencies and additions to tax for fraud determined by the Commissioner for those years. (R. 109.)

SUMMARY OF ARGUMENT

I. The Tax Court correctly upheld the Commissioner's determination of deficiencies for each of the taxable years 1939 through 1949. The findings of the Tax Court are supported by evidence and are not clearly erroneous. Taxpayer concedes that he grossly understated his taxable income for eleven successive years and that his aggregate actual income was at lease five times as much as he reported. The Commissioner has determined a larger aggregate, year by year, which clearly reflects taxpayer's actual income for each year. The Commissioner's determination is based upon direct proof of taxpayer's actual income from several sources. The exact amounts of income from interest, dividends and capital gains on real estate are not disputed and the amount of taxpayer's professional expenses is likewise undisputed. The only issue in the case is whether the determination of the taxpayer's gross professional receipts is supported by evidence.

This determination is based upon an extensive audit by taxpayer's accountant of gross receipts from patients, furnished to the Commissioner by taxpayer expressly for the purpose of showing his gross receipts. The accountant made a complete examination of all the patient record cards, in taxpayer's office, aided by consultation with taxpayer's two office employees, familiar with the records, and with taxpayer himself. Taxpayer is precluded from attacking the determination based on his own audit. On ordinary rules of evidence applicable to tax cases, the Commissioner was entitled to accept the taxpayer's au-

thorized audit as admitted proof of his actual gross professional income.

Even if the audit were not furnished by taxpayer himself, it amply supports the determination, since it was carefully checked by a revenue agent, who also consulted with the taxpayer's employees, and whenever they could not answer any question on a particular card, the agent took it up with the taxpayer himself.

Taxpayer's attack upon the determination of his income is without substance. The net worth statement, upon which taxpayer mainly relies, is accurate only as a determination that taxpayer's income was not less than the amount shown by use of the method. It falls before a computation made from taxpayer's actual records which shows that the income is larger than shown by the net worth method. Moreover, in this case the accuracy of the net worth statement depends upon taxpayer's unsupported assertions of opening cash and subsequent accumulations of cash, which constitute 48 per cent of the total assets shown on the net worth statement. Hence, the net worth statement cannot rebut the direct and positive proof of actual income shown by the audit of taxpayer's records aided by those familiar with the records, including taxpayer himself. The Commissioner did not accept the net worth statement as an accurate statement of taxpayer's assets, nor can the Commissioner be compelled to accept a taxpayer's net worth statement. On the contrary, the Commissioner is authorized by statute to select the method that clearly reflects income, and he is authorized to reject unsupported assertions of cash accumulations.

The taxpayer's claim that the audit was defective because some of the records were ambiguous is answered by the fact that the audit is not based upon the records alone but upon the records and the interpretation of the records by the persons, including taxpayer himself, familiar with the records. Taxpayer's further contention that the audit is defective, because taxpayer was ill for four months in one year and that it was impossible for him to do as much business as the audit showed, is not based upon any established facts but only upon unsworn assertions of the taxpayer, not directly testified to at the hearing.

II. The Tax Court correctly found that taxpayer filed a false and fraudulent return with intent to evade taxes for each of the years 1939 through 1948 so that the assessment and collection of deficiencies of the tax years is not barred by the statute of limitations and taxpayer is subject to the additional tax provided by Section 293(b).

The findings of fraud, on which the statute of limitations and additional taxes rest, are amply supported by undisputed evidence of a repeated pattern of gross understatements of income for ten successive years, concealment of income and admissions of the taxpayer. This evidence is more than sufficient to support the finding of fraud. None of the cases cited by the taxpayer are in point. The proof of fraud does not depend upon Duelke's credibility; but Duelke's credibility in any event is not before this Court, and his credibility is supported by the record. The disposition of the criminal charges is irrelevant.

III. The Tax Court correctly held that the returns filed for 1939 through 1942 were joint returns of the

husband and wife making each liable for any deficiencies with respect thereto under Section 51(b) of the 1939 Code. The facts on this branch of the case are not in dispute. The appeal is based solely on the ground that, as a matter of law, a wife who signs a joint return cannot be held liable for any deficiencies, based on fraud, in the absence of fraud on her part. Section 51(b) of the 1939 Code, however, imposes joint and several liability for all deficiencies upon both husband and wife, signing a joint return, regardless of participation in, or knowledge of, fraud. Section 51(b) was expressly changed in 1938 to impose such joint and several liability, after a decision by this Court construing the prior statute as not providing for such joint and several liability. Since the 1938 Act, the Third, Fifth and Sixth Circuits have squarely held that a wife is liable for all deficiencies, including the additions of fraud, regardless of her participation in or knowledge of the fraud. It is administratively impossible to draw a line based on the degree of the wife's knowledge or lack of knowledge of her husband's fraud or her benefits therefrom. Moreover, the liability imposed by Section 51(b) is the established civil liability of general partners or cosigners for each other's acts.

ARGUMENT

I

The Tax Court Correctly Upheld The Commissioner's Determination Of Deficiencies For Each Of The Taxable Years 1939 Through 1949

A review of the detailed findings and the carefully reasoned opinion of the Tax Court demonstrates that

its decision is correct, its findings are supported by evidence and are not clearly erroneous. *Pool* v. *Commissioner*, 251 F. 2d 233, 247 (C.A. 9th), certiorari denied, 356 U.S. 938, rehearing denied 356 U.S. 978.

A. *Taxpayer concedes that he grossly understated his taxable income for eleven successive years*

The deficiencies in question cover eleven successive calendar years, from 1939 through 1949. Taxpayer does not contest the deficiency determination for 1949 and further concedes a gross understatement of taxable income for each of the other ten years. Taxpayer's reported income for the ten-year period, 1939-1948, ranged from $4,555 in 1939 to $17,828 in 1948 for a total reported income for this period of $101,-407. This reported income is admittedly not a true statement of income for any one of these years. Taxpayer now admits that his aggregate actual income for this ten-year period was at least five times as much as he reported, or $529,854. (Br. 12.)[1] The Commissioner has determined a larger aggregate of $649,512. (R. 99.)[2] The year by year comparison

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[1] This is the original net worth figure supplied by the taxpayer. (Ex. 1; R. 126.) The Tax Court corrected it to $590,646 by adding adjustments developed at the hearing. (R. 100.)

[2] While the difference between the aggregate net income for this period as determined by the Commissioner and as claimed by the taxpayer is $120,000, the difference in tax deficiencies is nearly twice as much, because the taxpayer, in reconstructing his income by a net worth analysis has, largely through variations in the item of cash on hand, distributed his income evenly through the years. Thus, the deficiencies asserted by the Commissioner for the eleven

of the taxpayer's reported net income, the Commissioner's determination and taxpayer's reconstruction of net income is set forth in the statement of facts, *supra*. As we shall show below, taxpayer by his authorized agents admitted that the Commissioner's determination of the greater amount clearly reflected his actual income.

B. *The Commissioner's determination clearly reflects taxpayer's income*

1. *The item of income in controversy is taxpayer's gross professional income*

The foregoing differences between the Commissioner's determination of taxpayer's income and the taxpayer's presently claimed income rest upon the determination of the taxpayer's gross professional income, since the correct amount of taxpayer's income for each of the years in qupestion from other sources is not in dispute. These other sources include interest, dividends, and capital gains on real estate transactions, for a total of $70,351 for the eleven-year period.[3] The amount of the taxpayer's professional expenses are undisputed since the Commissioner allowed all claimed. (R. 374.) The issue in this case thus reduces itself to the question whether the determination of the taxpayer's gross profes-

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years amount to $332,780 plus additions for fraud of $168,477 for a total of $501,257. (R. 16, 28-29.) Taxpayer admits deficiencies of $196,620 plus additions for fraud, if the findings of fraud are upheld, of $100,392 for a total of $297,012 (Br. 18) or a difference of $204,245.

[3] Dividends are shown at R. 23, 24, 25, 26 and 40; interest, at R. 40; and capital gains, at R. 45, 48.

sional receipts by the Tax Court is supported by the evidence.

2. *The Commissioner's determination of the taxpayer's gross professional income is based upon the taxpayer's own audit*

It is difficult to see how the taxpayer here can object to the determination that has been made, for it is based upon an audit furnished to the Commissioner by the taxpayer himself. When the taxpayer was first approached by revenue agents, he claimed that he did not have all of the records that would show his income from payments received from his patients. (Br. 10; R. 90.) But in August, 1949, the taxpayer's attorney agreed to supply all of the records and furthermore stated (R. 357)—

> that there would be no longer a claim that there were files lost, and that they were going to make an audit of the record cards, patient record cards, in order to determine the amount of income Dr. Furnish had received and would present this audit to the Government.

This audit was subsequently made by the taxpayer's own accountant, Harry K. Hill, a certified public accountant, and turned over to the Government by taxpayer's authorized attorney in June, 1950, at a conference at which the accountant was present and explained his audit. (R. 358-360.)[4] The audit was an extensive one, based upon the accountant's complete examination of all the patient record cards

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[4] Hill did not testify at the hearing before the Tax Court because he was ill and the time of his recovery was indefinite. (R. 395-396.)

in taxpayer's office, aided by consultation with taxpayer's two assistants, who were familiar with the records and with taxpayer himself. (R. 101, 460, 472.) Taxpayer is precluded from attacking the determination based on his own audit. *Anderson* v. *Commissioner*, 250 F. 2d 242, 248 (C.A. 5th). On ordinary rules of evidence, this admission is sufficient to support a finding by the trier of the facts, that his income was as so stated. IV Wigmore on Evidence (Third ed.), Sec. 1078. As Wigmore declares:

> He who sets another person to do an act in his stead as agent is chargeable in substantive law by such acts are are done under that authority; so too, properly enough, admissions made by the agent in the course of exercising that authority have the same testimonial value to discredit the party's present claim as if stated by the party himself.

There is no question that the audit in this case was authorized by the taxpayer.

No different rule is applicable to a tax case. Thus, the Fourth Circuit in *Burka* v. *Commissioner*, 179 F. 2d 483, upheld a deficiency determination, where the Commissioner had adopted the audit by taxpayer's accountant of bank deposits and sales slips to determine gross income from the taxpayer's laundry business.

3. *The audit amply supports the determination, even if it were not supplied by the taxpayer*

When the revenue agents received the audit of taxpayer's gross receipts made by his accountant, Agent Ness carefully checked it, sampling 3,900 of

the 20,000 cards. (R. 360, 364, 369.) The special agent also consulted with the taxpayer's two office employees who were familiar with the records; and whenever they could not answer any question on a particular card, the special agent took it up with the taxpayer himself. (R. 101, 401, 406.) As the special agent testified (R. 406):

> * * * we consulted freely with Rose Saunders and Irma Wheeler in the office, and with Dr. Furnish when he was available, and when these questions arose at that time, we consulted with whoever was available and we determined what that card reflected.

The agent's sampling disclosed some discrepancies between the audit as made by taxpayer's accountant and the records, but these discrepancies were generally in favor of the taxpayer and were accepted unchanged by the Commissioner. (R. 92, 435.) The case at bar is a simple one in which the taxpayer's true income, grossly understated in his returns, has been determined by establishing the actual income received by the taxpayer from his several sources of income. Only one source of income is in dispute, namely his gross professional receipts, but these have been established from his own records, by his own accountant, aided by the taxpayer himself and his own employees. In short, this case is one in which the Commissioner has determined the taxpayer's income to be what he said it was.

4. *Taxpayer's attack upon the determination of his true income is without substance*

(a) The net worth statement does not clearly reflect income

The taxpayer has placed his main attack upon the Commissioner's determination of his income, upheld by the Tax Court, on the contention that the net worth analysis of taxpayer's income, prepared by another accountant, more accurately reflects the taxpayer's income than does income as shown by the audit. (Br. 20-22.) The attack fails because a net worth reconstruction of income is not direct proof of income, whereas the audit is direct proof of actual income from the original entries. See *Bechelli* v. *Hofferbert*, 111 F. Supp. 63 (Md.).

It is hardly necessary to labor the point that a net worth statement is a reconstruction of income based upon circumstantial evidence, dependent upon a discovery of all assets from which the existence of income can be inferred, useable where no adequate, or only false records are available. *Holland* v. *United States*, 348 U. S. 121; *Remmer* v. *United States*, 205 F. 2d 277, 287 (C.A. 9th), reversed on other grounds, 347 U. S. 450. A critical item in a net worth reconstruction of income is cash—opening cash and subsequent cash accumulations. This cash item is especially critical in the case at bar, since the net worth statement shows on its face that opening cash and cash accumulations for the eleven-year period constituted 48 per cent of total assets. The critical amount of cash is not established here by any independent evidence, as required by the decided cases.

Holland v. *United States*, *supra*, *Friedberg* v. *United States*, 348 U. S. 142; *Anderson* v. *Commissioner*, 250 F. 2d 242 (C.A. 5th). Taxpayer's claim of cash was not established by any records whatever. (R. 242-244, 249, 382.) Indeed, taxpayer's accountant testified that he had no way at all of verifying the taxpayer's statement of his opening cash in the substantial amount of $46,000 (R. 353, 376); and the estimated amounts of subsequent accumulations of cash, furnished to the accountant by the taxpayer, had to be revised by the accountant in the light of known expenditures (R. 244-245). The net worth statement is thus nothing more than taxpayer's assertion of his gross income, not made under oath or subject to cross-examination; and uncorroborated by any cash records of bank deposits or other methods of keeping the alleged cash. It is not competent proof and it certainly cannot rebut the evidence of income shown by an audit of taxpayer's records, aided by those familiar with the records, including taxpayer himself. *Smith* v. *United States*, 348 U. S. 147.

Contrary to taxpayer's assertions (Br. 21-22) the Commissioner did not accept the net worth statement as an accurate statement of the taxpayer's assets. On the contrary, as Agent Ness testified, had the Government intended to rely upon the net worth statement, it would have made "a close inquiry on the cash figures." (R. 428.) Plainly, the Commissioner cannot be compelled to accept a net worth analysis, and he is as a matter of law and reason authorized to determine taxpayer's income from his records rather than from his unsworn assertions. *Miller* v. *Commissioner*, 237 F. 2d 830 (C.A. 5th).

In the *Miller* case, the precise contention of taxpayer here was rejected by the court on the two-fold ground that (a) the Commissioner has statutory discretion under Section 41 of the 1939 Code, *supra*, to select the method that clearly reflects income, and (b) the net worth method depends upon taxpayer's assertion of past cash accumulations which the Commissioner need not accept. In this case, as in the *Miller* case, the Tax Court properly rejected taxpayer's claim of opening cash. (R. 100.)

(b) There are no errors in the audit

The taxpayer's second ground of objection to the determination based upon the audit of his records is that some of the records are ambiguous. Thus the taxpayer says (Br. 23):

> To rely on the method used by the respondend to determine the taxable income of the petitioner would be resorting to conjecture and surmise of the worst order. It is clear from the testimony of witnesses who were familiar with the records of the petitioner that one could not determine from an inspection of the record whether an item was paid or whether the patient was merely given a credit without any payment having been made.

But the short answer to this contention is that the Hill audit and the check made by Agent Ness did not rely upon the records alone, but upon the records and the interpretation of the records by the persons, including taxpayer himself, familiar with the records. All of taxpayer's argument about wavy lines and other symbols on the cards is beside the point; the office employees knew what each card meant (R. 462-

463, 473); and they were freely consulted by both Hill and Agent Ness.

(c) The other objections are unsupported by any evidence

Taxpayer makes two last points in his attack on the deficiency determination, neither of which is based upon established facts; namely, that the taxpayer did not practice medicine for four months in 1944, and that it was not possible for the taxpayer to do as much business as the Hill report showed. (Br. 24.) These are not established facts, but assertions reportedly made by the taxpayer to a witness; they were not testified to directly by the taxpayer, or anyone else having competent knowledge of the facts, directly at the hearing under oath and subject to cross-examination. Obviously, this sort of "proof" proves nothing except that the assertions were made. See *Meier* v. *Commissioner*, 199 F. 2d 392 (C.A. 8th). As the Tax Court stated in its summary of the evidence (R. 100-102), the determination of the taxpayer's actual income is based upon an extensive audit made by an agent of the taxpayer and presented to the Commissioner by the taxpayer for the express purpose of showing his gross income. It thus furnished "strong support" for the Commissioner's determination. (R. 101.) The Commissioner, however, did not let the matter rest there. His agents checked the audit against the cards, aided by taxpayer himself and his employees. As the Tax Court rightly concluded (R. 101):

> In these circumstances, the Hill report is powerful evidence that petitioner received the amount of the fees shown therein.

II

The Tax Court Correctly Found That Taxpayer Filed A False And Fraudulent Return With Intent To Evade Taxes For Each Of The Years 1939 Through 1948 So That The Assessment And Collection Of Deficiencies Of The Tax Years Is Not Barred By The Statute Of Limitations And Taxpayer Is Subject To The Additional Tax Provided By Section 293(b)

The findings of fraud, on which the bar of the statute of limitations and additional taxes rest, are amply supported by undisputed evidence of a repeated pattern of gross understatements of income for ten successive years,[5] concealment of income and admissions of the taxpayer. Even with the elimination of capital gains and stock dividends, alleged to be innocent errors (Pet. Br. 28-29), the taxpayer concedes, as noted above, gross undertatements of other income, and the Commissioner has proved more than taxpayer now admits. It is not necessary on the fraud issue for the Government to prove the exact amounts of unreported income. *Remmer* v. *United States, supra.*

The fact of unreported income for ten successive years is alone sufficient evidence to support the finding of fraud. *Holland* v. *United States, supra*; *Bender* v. *Commissioner* (C.A. 7th), decided July 1, 1958 (58-2 U.S.T.C., par. 9650) (7 years); *Harber* v. *Commissioner*, 249 F. 2d 143 (C.A. 6th) (7 years), certiorari denied, 355 U. S. 955; *Anderson* v. *Commissioner*, 250 F. 2d 242 (C.A. 5th) (4 years); *Schwarzkopf* v. *United States*, 246 F. 2d 731 (C.A.

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[5] The Tax Court found no fraud for 1949. (R. 105.)

3d) (6 years); *Harris* v. *Commissioner*, 174 F. 2d 70 (C.A. 4th) (6 years); *Rogers* v. *Commissioner*, 111 F. 2d 987 (3 years); *Seifert* v. *Commissioner*, 157 F. 2d 719 (C.A. 2d) (5 years). Taken with the other circumstances in this case, the proof of fraud is as strong as it can possibly be. Thus, taxpayer falsely told the revenue agents at the commencement of the investigations that he did not own the real property and that he had lost some of his patient records. He refused to install an accurate bookkeeping system. Taxpayer used many devices to conceal his ownership of property, taking of title of property in the name of nominees, using cash, especially bills of small denominations, to make substantial purchases, and sending patients' checks to a sister in Kansas. There is, further, his undenied admission to the revenue agent that he may have been guilty of evasion. All of these circumstances, noted the Tax Court, "afford strong and powerful proof" that the returns were false and fraudulent and that the "wide discrepancies were not the result of innocent mistakes but were part of a calculated plan to defraud the Government". (R. 103, 104.)

The cases cited by the taxpayer (Br. 24-26) are not in point. *Wiseley* v. *Commissioner*, 185 F. 2d 263 (C.A. 6th), is clearly distinguishable on its facts. In that case the taxpayer-doctor quickly remedied his negligent failure to report income before any question was raised by the Commissioner. The facts in the case at bar are more like those in *Harber* v. *Commissioner*, *supra*, where the Sixth Circuit held that a doctor who had failed to report substantial in-

come from his professional fees and real estate transactions was guilty of fraud and was not to be excused by a claim of "busyness" or incompetent office help.

Taxpayer's factual objections to the proof of fraud have little weight. The fact that the taxpayer here may have had other reasons for secreting income, strenuously argued by taxpayer (Br. 27-28), does not excuse his failure to report the income on his tax return. *Lipsitz* v. *Commissioner*, 21 T. C. 917, 937, affirmed, 220 F. 2d 871 (C.A. 2d). The evidence of other purposes simply comes from the statement of nominees as to the reasons given to them by the taxpayer for his use of their names; and obviously; as they said, they would not have allowed the taxpayer to use their names if he had told them that he was doing so in order to evade taxes. (R. 238, 301.) Nor is it important or competent for this Court to weigh the credibility of the taxpayer's business agent, Duelke. The Tax Court's finding of fraud does not, as taxpayer asserts (Br. 29), rest upon Duelke's testimony. His testimony that taxpayer was not worried about a Government investigation is only one item of evidence of fraud. This case stands without it. But in any event, Duelke's testimony is credible. The taxpayer himself did not take the stand to deny the statement attributed to him by Duelke; and Duelke's credibility is not in any way impeached by the testimony of Anspach. At best Duelke and Anspach had different recollections of a conversation that took place ten years ago. Moreover, Anspach himself is a character witness for Duelke; Duelke seemed to him to be a "high class man". (R. 391.)

Taxpayer's reference to the statement by Judge Yankwich (Br. 31) in connection with the criminal prosecution is, as the taxpayer himself notices, irrelevant. *Helvering* v. *Mitchell*, 303 U. S. 391. Furthermore, at the hearing before Judge Yankwich, taxpayer's attorney urged that the 50% addition to tax for fraud was punishment enough. (Ex. 4, p. 5.)

In sum, the finding of fraud in this case rest upon the undisputed gross understatement of income for ten years, together with the surrounding circumstances of failure to keep records, concealment of assets, and admissions of evasion. On the basis of this record supported finding, it follows that none of the deficiencies for the early tax years was barred by the statute of limitations, and further that the statutory additions for fraud are applicable to each of the tax years.

III

The Tax Court Correctly Held That The Returns Filed For 1939 Through 1942 Were Joint Returns Of The Husband And Wife, Making Each Liable For Any Deficiencies With Respect Thereto Under Section 51(b) Of The 1939 Code

This branch of the case involves the liability of Mrs. Funk, who was the wife of the taxpayer from 1923 until their divorce in 1944, for the deficiencies assessable on their joint income for four tax years, 1939 through 1942, in the amount of $52,931.87. (R. 22.)

The facts are not disputed (Funk Br. 2) and are set forth in the findings and opinion of the Tax Court

(R. 106-110). There is no question that Mrs. Funk signed the returns, knowing they were joint tax returns. (R. 108, 445-446.) Her appeal is based upon the contention that, absent any fraud on his part, she cannot be held liable for any deficiencies whatever, since the tax years are otherwise barred by the statute of limitations. A person, counsel contends, should be liable "on what they sign or from which they benefit." (Funk Br. 4.)

We submit that Mrs. Funk is simply being held liable here on what she signed. Section 51(b), *supra*, clearly specifies that the liability of a husband and wife on a joint return with respect to the tax shall be "joint and several;" and the decided cases hold that both spouses are liable regardless of who is the actor in the fraud.

A. *The legislative history of Section 51(b) shows that Congress clearly intended to impose joint and several liability on the husband and wife as a condition to the privilege of securing the benefit of lower tax rates by a joint return*

The Congressional intent is expressly disclosed by specific amendment. Prior to 1938, Section 51(b) appeared in the Revenue Act of 1936, c. 690, 49 Stat. 1648, which read as follows:

> (b) *Husband and Wife.*—If a husband and wife living together have an aggregate net income for the taxable year of $2,500 or over, or an aggregate gross income for such year of $5,000 or over—
>
> (1) Each shall make such a return, or
>
> (2) The income of each shall be included in a single joint return, in which case the

tax shall be computed on the aggregate income.

This provision was construed by this Court as *not* imposing joint and several liability. *Cole* v. *Commissioner*, 81 F. 2d 458. Its decision was followed by other circuits. *Crowe* v. *Commissioner*, 86 F. 2d 796 (C.A. 7th); *Commissioner* v. *Rabenold*, 108 F. 2d 639 (C.A. 2d); *Sachs* v. *Commissioner*, 111 F. 2d 648 (C.A. 6th.) Contra: *Moore* v. *United States*, 37 F. Supp. 136, (C. Cls.), certiorari denied, 314 U.S. 619, rehearing denied, 314 U.S. 706.

Because of the *Cole* decision, Congress in Section 51(b) of the Revenue Act of 1938, c. 289, 52 Stat. 447, 476, changed the language of the section to expressly provide that the liability shall be joint and several. That language was re-enacted into Section 51(b) of the 1939 Code, controlling here.

While the language of Section 51(b) of the 1938 Act speaks for itself, for the information of this Court, the following authoritative explanation of the section by the Report of a Subcommittee of the Committee on Ways and Means, 75 Cong., 3d Sess. (House Hearing, Revision of Revenue Laws, 1938, pp. 57-58) is printed:

JOINT AND SEVERAL LIABILITY ON THE PART OF HUSBAND AND WIFE FILING JOINT INCOME RETURNS

The Congress has long granted the privilege of filing joint returns to husbands and wives living together (see sec. 51(b)(2) of the Revenue Act of 1936). If such a return is filed the

tax is computed upon the aggregate net income of the two spouses and in many cases is less than the taxes would be if the spouses filed separate returns.

Since a joint return does not show the respective incomes and deductions of the husband and wife, individually, and since under the statute a single tax is computed upon the aggregate income, the Bureau of Internal Revenue has taken the position for many years that the filing of such a return by husband and wife creates a joint and several liability on their part for the tax on their aggregate net income; and that deficiencies, penalties, and interest may be collected from either or both of them.

The Bureau's interpretation has been sustained by the Board of Tax Appeals in various cases but was rejected by a divided court in *Cole* v. *Commissioner* (81 F. 2d 485).

In the opinion of your subcommittee the Bureau's position is sound; and to avoid further confusion and litigation it is recommended (Recommendation No. 41) that an amendment be inserted in the statute to make it clear that if a husband and wife choose to file a point return, each of them will be liable for the tax upon their aggregate income, and for any deficiencies, penalties, and interest in respect of the joint return which may thereafter be determined. Unless the husband and wife the to be held jointly and severally liable for the tax upon their aggregate net income it will be necessary for the Bureau to require that their individual incomes and deductions shall be separately stated in the return, in order that their respective income-tax liability may be separately

determined. Such a requirement would cause considerable hardship upon taxpayers with moderate incomes and would largely eliminate the advantages of the joint return.

The Subcommittee's Recommendation No. 41 referred to in the above report, reads as follows (House Hearings, *supra*, p. 85):

JOINT AND SEVERAL LIABILITY ON THE PART OF HUSBAND AND WIFE FILING JOINT INCOME RETURNS

Recommendation No. 41.

It is recommended that there should be expressly stated in the Revenue Act that there is a joint and several liability for tax on the part of husband and wife on the filing of joint returns and that a joint deficiency notice is proper in such cases.

There can, therefore, be no doubt that Congress intended that a person signing a joint return becomes liable for all deficiencies.

B. *The decided cases have squarely carried out the plain terms of the statute and held a spouse liable for all deficiencies, including those for fraud, regardless of participation in the fraud*

Following the 1938 Act the courts have squarely held that a wife is liable for all taxes including the additions for fraud, regardless of her participation in or knowledge of the fraud. *Howell* v. *Commissioner*, 175 F. 2d 240 (C.A. 6th); *Kann* v. *Commissioner*, 210 F. 2d 247 (C.A. 3d), certiorari denied, 347 U. S. 967; *Boyett* v. *Commissioner*, 204 F. 2d 205 (C.A. 5th); *Sullivan* v. *Commissioner* (C.A.

5th), decided May 26, 1958 (58-2 U.S.T.C., par. 9563); see also *Commissioner* v. *Uniacke*, 132 F. 2d 781 (C.A. 2d).[6] The *Howell* court, like the Tax Court below, said that this result is required by the statute (175 F. 2d 241):

> We think petitioner's contention has no merit. Petitioner seeks in effect to have this court amend Sec. 51(b) of the Revenue Act of 1938 by holding that under the circumstances there described the liability of husband and wife with respect to the tax shall be joint and several in case only of non-fraudulent returns. The courts are not authorized to make changes in statutes, and the express wording of Sec. 51(b) requires the contrary conclusion. The 50% penalty is required by the statute under this record, Sec. 293(b), Internal Revenue Code, 26 U.S.C.A. Sec. 293(b), and is a civil penalty. *Helvering* v. *Mitchell*, 303 U. S. 391, 58 S. Ct. 630, 82 L. Ed. 917. The deficiencies in income tax constitute a civil liability. The existence of liability both for the penalties and the deficiencies is determined by the wording of Sec. 51(b), which makes no distinction as to whether the transactions out of which the liability arises are fraudulent or nonfraudulent.

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[6] The dicta in *Macias* v. *Commissioner* (C.A. 7th), decided May 7, 1958 (58-1 U.S.T.C., par. 9507), rests upon erroneous view that the additions for fraud are separate penalties, not part of the tax. See *Helvering* v. *Mitchell*, 303 U. S. 391. But even on this premise, the wife would be liable for the deficiencies on the true income, apart from the "penalties". It is also to be noted that the Subcommittee Report, *supra*, including penalties, was not called to the Court's attention.

> The Tax Court's findings are supported by ample evidence and are binding in this court. The fact that petitioner was not the moving spirit in the fraud is immaterial on the question of her liability.

It is, we submit, impossible, as Mrs. Funk contends, to draw a line based on the degree of the wife's knowledge or lack of knowledge of her husband's fraud, or her benefits therefrom.

None of the cases cited by counsel for Mrs. Funk are in point. Indeed, as noted, the decision in *Cole* v. *Commissioner*, *supra*, was directly responsible for revision of Section 51(b) which imposes liability on her.

The rule of joint and several liability of joint agents or co-signers for each other's fraud, where only one is guilty of the fraud, is not confined to tax cases; on the contrary, in Code Section 51(b) Congress has simply invoked a general principle of liability of joint partners or co-signers, *Philips* v. *United States*, 59 F. 2d 881 (C. A. D. C.), certiorari denied, 287 U. S. 639; *Brown* v. *Oxtoby*, 45 Cal. App. 2d 702, 709; *Williamson* v. *Clapper*, 88 Ca. App. 2d 645, 650; and see also *Amen* v. *Black*, 234 F. 2d 12 (C.A. 10th), remanded for dismissal on settlement, 355 U. S. 600.

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

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